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TAGS: PGOV PREL IS GOI INTERNAL ECONOMY AND FINANCE

SUBJECT: BUDGET MAY FAIL, BUT SHRINKING SHARON GOVERNMENT SURVIVES

Classified By: Political Counselor Norman H. Olsen for reasons 1.4 B and D.

1. (C) The anticipated 43-54 failure of PM Sharon's budget late December 1, and the anticipated post-vote dismissal of Shinui ministers, leaves Sharon with a Likud-only government, but does not cause the government to fall. Sharon can bring the budget back to the Knesset as many times as he wants. Shinui Chief Tommy Lapid remains determined at mid-day to vote against the budget because of Sharon's NIS 290 million buyoff of UTJ's five votes, despite the fact that Sharon gave him one "out" late November 30 with talk of the excessive cuts already taken by the religious community and another at noon December 1 with talk of possible budget allocations to Shinui-preferred sectors. Lapid supposedly rejects a Shinui abstention, which, with possible abstentions by Shas, the Arabs, and two independents, would allow Sharon to win 43-42-35, and allow Shinui to remain in the coalition. Lapid's rejection notwithstanding, noontime chatter in the Knesset is of a possible Shinui compromise.

2. (C) Sharon today has 38 Likud votes; Likud MK David Levy is against, and another Likud MK is hospitalized. If the budget does fail, Sharon can try to buy additional religious votes (Shas-11, NRP-6) via budget allocations altogether totalling probably less than NIS 700 million. With possible abstentions, that may be enough to win the necessary simple majority for budget passage. If Sharon is determined to bring Labor into the coalition, as Shimon Peres claims, then he will need to address Labor's broader objections to both the budget and to finance reform. Talk at mid-day in the Knesset and from a Foreign Ministry official is of Labor's demands really not being "monumental," but Labor MK Collette Avital told poloff late December 1 that some Laborites will want to re-write the budget. Since Labor will go for disengagement anyway, and would make such a fractious coalition partner, the possibility remains that Sharon may string Labor along, much as he has been doing since last May. Peres, and a Finance Ministry budget official who spoke to econoff, say Sharon would use a failed budget vote to demonstrate to Likud that it needs Labor. Amid leadership turmoil and the return to party politics of former PM and Labor leader Ehud Barak, Labor has put off setting a date for party primaries, leaving the opening for unity talks that the media says are to start 48 hours after Shinui is out of the coalition.

3. (C) COMMENT: This could all be Sharon clearing the decks now for disengagement, rather than waiting until closer to the planned March 1 vote on first-phase disengagement. A new coalition now with Labor, in particular, would also stymie talk of new elections -- which are opposed by some 73 percent of the public -- and leave Sharon clear to focus solely on disengagement. If a unity government is to emerge, either Labor will face a climbdown from its previous budget rhetoric, or Sharon will have to accept further erosion of his budget and economic reform plans. Sharon has demonstrated clearly now for some seven months that he has no aversion to governing from a minority coalition, building issues-specific, ad hoc alliances.

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